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Supreme Court of The United States

October Term 1948

No. 21

MERREL P. CALLAWAY, AS TRUSTEE OF THE PROPERTY OF CENTRAL OF GEORGIA RAILWAY COMPANY, DEBTOR, ET AL., PETITIONERS

Vs.

L. O. BENTON, JR., ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

REPLY BRIEF TO THE BRIEF FOR RESPONDENTS

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I

AS TO THE CONTENTION IN RESPONDENTS' BRIEF THAT NEITHER THE PLAN, NOR THE ORDER OF COURT APPROVING THE PLAN PROVIDE THAT THE PROPERTIES OF SOUTH WESTERN MAY BE ACQUIRED BY A SIMPLE MAJORITY VOTE OF THE STOCKHOLDERS OF THE COMPANY.

The Plan did not say any thing about the vote of stockholders, because this is a matter which is regulated by the Federal Statutes. Section 5 (11) of the Inter-

state Commerce Act provides for a majority vote of stockholders unless a different vote is required under applicable State law. This Section further relieves the carrier from the "restraints, limitations and prohibitions of law, Federal, State or Municipal in so far as may be necessary to enable them to carry into effect the transaction so approved"; and this Section further provides that the powers granted by the Section "shall be deemed to be in addition to and in modification of its powers under its corporate charter or under the laws of any State." The authority conferred by this section is "exclusive and plenary." If there is any State Statute which comes into conflict with this Federal law, the State Statute must yield.

Section 77 (f) of the Bankruptcy Statute gives authority to carry out the plan, "the laws of any State or the decision or order of any State authority to the contrary notwithstanding."

The reorganization is controlled by Federal law and not by State law.

We have called attention in our main brief (p. 9) to the provision in the last paragraph of the Plan (R. 47) which provides that nothing contained in the plan shall be construed as a grant of authority for the issue of securities, transfer of any property, sale, consolidation or merger of the Debtor's property "until further action by the Commission upon confirmation of the plan by the Court." Benton's suit was brought before the confirmation of the plan and the State Court usurped the functions and power of the Commission and the Reorganization Court in decreeing that the

South Western should not accept the plan without unanimous stockholder consent. The State Court passed this decree after South Western's stockholders by a large majority had assented to the plan and the corporation had notified the Commission of its acceptance.

II

NEITHER THE COMMISSION NOR THE COURT ABANDONED THEIR RESPECTIVE FUNCTIONS TO PASS ON THE ACCEPTANCE OF THE PLAN OR ITS VALIDITY.

The Respondents' Brief reiterates in three places (pp. 18, 20 and 23): "Whether the properties of this Company could be acquired by the Debtor or the reorganized Company on the terms set forth in the plan was left by the Commission and by this Honorable Court to the stockholders of the Company to decide. Whether the acceptance on the part of the Company could be based on a vote of the majority of the outstanding stock was a question as to which this Respondent and other stockholders on the one hand and the officers of the Company, on the other hand, differed." And again Respondents brief states (p. 20): "The stockholders are in dispute as to what constitutes a valid acceptance."

Respondents' Brief goes on to argue because the officers of the Company and the minority stockholders differed on this subject the State Court had the right to decide the dispute and to ignore the fact that there was a reorganization proceeding pending in the Federal Court which was directly concerned with this matter. The Benton case ignored the Trustee of the Debtor's property and did not make him a party to the suit, and yet this suit invoked a decision from the State

Court enjoining the acceptance of the reorganization plan, which was a matter of which the Reorganization Court necessarily had exclusive jurisdiction and the State Court enjoined the South Western and its Officers and Directors "from doing or performing any act in behalf of the defendant railroad company which might tend to consummate the plan of reorganization of the Central of Georgia Railway Company with respect to the acquisition of the properties of South Western Railroad Company."

This was a flagrant violation of the jurisdiction and powers of the reorganization Court.

It is a curious contention that because a minority stockholder choses to raise the contention that the Corporation of which he is a stockholder cannot convey its property without unanimous stockholder consent, the reorganization Court thereby loses its jurisdiction over the acceptance of the plan and the validity of the acceptance, which are matters within the frame work of the reorganization process. In other words the functions of the Court and the Commission are to be ignored while the stockholders fight out among themselves a question over which the Federal Statutes have taken exclusive and plenary jurisdiction.

Respondents' Brief further argues that because no one had raised in the Bankruptcy proceeding the contention that South Western could not convey its property without unanimous stockholder consent, that he was at liberty to raise this question in the State Court and because he first raised the question in the State Court, the State Court had prior jurisdiction over the question.

No one had raised the question in the reorganization proceeding because there is nothing in the point, and if the Respondent prevails on this question, although he might win his case, he would lose his property. Moreover South Western was a party to the reorganization proceedings, and its acceptance or rejection of the plan had to take place in the reorganization proceeding, therefore the proper and the only place to raise this question was in the reorganization Court.

III

THE CONTENTION IN THE BENTON SUIT OF MISMANAGEMENT OF SOUTH WESTERN IS NOT INVOLVED IN THE PROCEEDING BROUGHT BY THE TRUSTEE OF THE DEBTOR TO ENJOIN THE BENTON SUIT.

In heavy black letters Respondent's Brief (p. 16) states, "The Federal Court was not asked to adjudicate the question of mismanagement." This statement is correct. There was no reason why the Trustee of the Debtor should have asked the reorganization Court to explore the allegations of mismanagement in the Benton Suit. It was no concern of the reorganization plan whether there was mismanagement of South Western or not; that question did not bear on the validity of the acceptance by South Western of the plan.

The mismanagement alleged in the Benton Suit (R. 114, par. 61) was as follows: "The action of the Board of Directors in disobeying the repeated and almost unanimous desires of the stockholders with respect to a sale of these properties, constitutes a strong case of mismanagement which should be enjoined by this Court of Equity." The allegations preceeding para-

graph 61 of the Benton Suit are to the effect that on several occasions both the Directors and Stockholders of South Western passed strong resolutions stating that the proposal of the plan was unfair and inadequate and that it should be rejected. All of these meetings were held prior to the submission of the plan by the Commission to South Western for its acceptance or rejection. The plan was not submitted by the Commission to South Western until February 11th, 1947 (R. 48, par. 12). Prior to this time South Western had made strenuous efforts to sell or lease its property, and had not succeeded in doing so. The "ox was in the ditch" and South Western then had to make a fateful decision. The Directors of South Western decided it was expedient to accept the plan (R. 116). These resolutions were transmitted to the stockholders and were accompanied by a letter from the President of the Company dated March 14, 1947 fully explaining why previously the Directors had taken the position that the plan should be rejected and why under the exigencies of the situation they had changed their minds and now recommended its acceptance (R. 80). This letter was followed by three other letters from the President of South Western to its stockholders explaining why the Directors had recommended the acceptance of the plan (R. 84).

Benton's suit also criticized the Directors of South Western for not taking an appeal from the order of the Court approving the plan and the allotment made to South Western.

The response of South Western (R. 122) fully explained why the Directors had finally concluded to

advise the acceptance of the plan and the futility of an appeal from the order approving the plan.

Finally, the Judge of the State Court in his order passed April 24, 1947 (R. 173, 174) held that under the evidence there was no mismanagement and the relief sought on that ground was unwarranted.

IV

THE CONTENTION AS TO SOLICITATION OF PROXIES.

The Respondents raise this question in the Statement of Facts in their brief (pp. 18 and 19) and argue it (pp. 58-61), and rest their contention on Section 77 (p) of the Bankruptcy Act copied in the appendix of their brief.

The Act makes it unlawful for any person during the pendency of a reorganization proceeding to solicit any proxy "from any creditor or shareholder of any railroad corporation by or against whom such proceedings have been instituted."

The plan was submitted by the Commission to South Western Railroad Company for acceptance or rejection. It was not submitted by the Commission to the stockholders of South Western (R. 48, 49). The Company accepted the plan subject to the assent of its stockholders (R. 116). 30,137 shares of stock voted to accept the plan and 9,057 voted against acceptance (R. 49). The Capital Stock of South Western consists of 51,911 shares (R. 44).

The contention in the response of Benton, et al. to the petition of M. P. Callaway, the Debtor's Trustee

(R. 14) was that proxies for 6,269 shares of South Western stock had been solicited by Samuel L. Varnadoe, a stock broker employed by the management of the Debtor.

There was no proof whatever that the Management had employed Varnadoe. On page 17 of Respondent's brief reference is made to a statement of the Attorney for Benton et al made by him at the Stockholders meeting in which he said that "it is my information—I don't state it as a fact—I want to state it is my information, those shares (referring to the 6,269 shares) were obtained by solicitation of Varnadoe, Chisholm & Co. or their employees, upon the employment of the Central of Georgia Railway Co." The pleading further stated "Mr. Varnadoe, a member of said brokerage firm and Mr. T. M. Cunningham, Counsel for the Trustee were present when this statement was made. It was not denied." There was no obligation on either Mr. Varnadoe or Mr. Cunningham to either admit or deny the statement of Benton's attorney.

Under the facts found by the District Court (R. 54 par. 23) the District Court found, "It appears from the undisputed evidence that proxies for 4,990 shares of stock out of the 6,269 shares were not solicited by Mr. Varnadoe, that the holders of these 4,990 shares were all clients of Mr. Varnadoe to whom he had sold the stock and that they voluntarily and of their own motion requested him to represent their stock. He admitted that the proxies for the other 1,279 shares of stock had been solicited by him." There was no finding of fact that the Management of the Debtor or Central of Georgia Railway Company had employed

Mr. Varnadoe. It was stipulated that the findings of fact by the Court were correct (R. 72 par. 2).

So that the question which is raised is not borne out by the facts. The vote for acceptance was 30,137. Throwing out the 1,279 votes which were solicited, there would remain 28,858 votes for acceptance and a majority of votes is 25,956.

But the solicitation of proxies from the stockholders of South Western does not fall within sub section (p) of Section 77 of the Bankruptcy Act and is not unlawful.

The Act merely prohibits the solicitation of proxies from Creditors and from Stockholders of the Debtor. South Western is a creditor of the Debtor, but no proxy was solicited from South Western. The Corporation by resolution of its Directors accepted the plan, therefore there was no necessity to solicit any proxy from this Creditor. The proxies which were solicited were from the stockholders of South Western. These stockholders were not creditors of the Debtor.

Stockholders are not agents of a corporation, do not own the property of the corporation, can not contract in its behalf and are not liable for its debts. The relation of Debtor and Creditor does not exist between a corporation and its stockholders, and the stockholders are wholly distinct from the corporation.

Cook on Corporations, Sections 267, 271, 709.

If the stockholders of South Western are not creditors of South Western, a fortiori they cannot be creditors of the Debtor.

This statute is in derogation of common right and should be strictly construed.

The District Court in its Conclusions of Law No. 22 (R. 68, 69) held that the contention was not supported by the facts, that is that not enough shares were solicited to affect the result, and that as a matter of law the solicitation of proxies from stockholders of South Western was not prohibited by the Statute.

The Circuit Court of Appeals in its decision did not notice the point.

Respectfully submitted,

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